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U S I N E S S

U D G E T I N G

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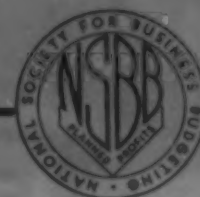
PLAN TO ATTEND

NSBB NATIONAL
CONVENTION

Minneapolis - St. Paul

MAY 21 - 22, 1959

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MID-YEAR LETTER FROM THE NATIONAL PRESIDENT

At mid year I can report to the membership that the affairs of the Society are in good order and that we are on the way to accomplishing our goals. Your national officers, directors, and committee chairmen and members are working hard at making NSBB a "living" organization and NSBB benefits are being extended to more practicing budget men through new chapter formation and through increased membership in existing chapters.

While it is not physically possible to visit each chapter, I have visited eight or ten. The national officers and directors met in Houston and Dallas last fall for chapter meetings (as well as committee and directors meetings which were very productive). I attended a Kalamazoo Chapter Meeting in October and meetings in St. Louis and Louisville in November (the Louisville meeting was the annual four-chapter meeting), visited Chicago and Calumet Region meetings in December, and the new Joliet-Kankakee Chapter for charter presentation in January. I'm going to present the charters to the new Fox River Valley Chapter (Illinois) in February and the new Kansas City Chapter in March. All of these visits have augmented my feeling that NSBB is doing a good job for its members and for the budgeting community. I'm always impressed when I meet and work with the men NSBB has in its chapters -- men willing to devote time and hard work to the success of those chapters.

Most of you are aware of the achievements of the Chapter Formation Committee this year under the very able direction of Vice President

Don Bacon and his fine regional organization because this is a committee where accomplishments stand out. We are all pleased at the way NSBB is being brought to budgeting men in many new locations. A great deal more is going on behind the scenes in this area but announcement of that will come after the fact. In the meantime, we ask continued help of members in sending to the Chapter Formation Committee the names of able budgeting men in cities where NSBB does not have a chapter.

I attended the meeting of the Research Committee in November and I can report that its members are working hard and intelligently on the textbook project. You have recently read the complete Business Budgeting article by Dewey Borst dealing with this subject.

Other committees are, of course, active -- much of their activity looking toward reports to the Board of Directors at the May meeting.

One final word: You will be contacted in many ways urging your attendance at the May 1959 annual conference in Minneapolis but I would like to add my special emphasis and ask that you plan now to attend. This is your Society's annual conference, your chance to trade problems and solutions in the budgeting field with a much wider and more varied group than you could possibly have in your own chapter. I urge you to come and to bring your wife; you won't be disappointed.



Hal Mason

By: Charles Ferguson
Management Consultant
Lifson, Wilson and Ferguson
Dallas, Texas

THE INDUSTRIAL ENGINEERING APPROACH TO BUDGETING

The combining of industrial engineering techniques to the preparation of budgets and analysis of performance is the theme of this article. Numerous charts are presented depicting the manner in which the engineering approach can be utilized in setting standards for operations — not only for manufacturing processes, but also for establishing target objectives for balance sheet items and profits. It is what the title says, an "Engineering Approach to Budgeting."

It is a pleasure to discuss budget methods with a group which has a fine appreciation of an adequate budgetary control system. One of the first things which should be stated is that the objective of each of the methods discussed is to improve the accuracy or effectiveness of:

1. Setting performance standards
2. Predicting costs (income or flow)
3. Controlling performance.

Each of these functions is well understood but I would like to make clear, their exact meaning as I use them.

From an engineering standpoint, the setting of performance standards is performed principally for those items which are controllable in the short range. Engineered standards are an expression of costs which should be obtained when specified methods are used and when the operation is under control. Such standards may be set concurrently with development of methods improvements, but these are two distinct functions and should not be confused. It is also necessary to emphasize that standards are based on known methods and should not imply methods improvements.

Standards are set through engineering analysis which determines the optimum expenditure of effort and materials to accomplish the desired task, using the best known methods. Such standards are normally quite different from actual experience during some past period. This is true because the development of optimum conditions of an operation require a thorough and systematic analysis which cannot be achieved in a random fashion. If standards are taken as an arbitrary

reduction of past actual expenses, they represent a guess at what the standards should be, and are difficult to get accepted.

Accurate prediction (as opposed to setting performance standards) is the objective in certain instances, such as, during the interim period, while real standards are being set, for cash flow projections, for bidding and setting prices, and other planning functions.

The third major aspect of budgeting to be discussed is that of control. By "control" is meant the "action taking" phase of the budgeting program. If the standards and allowances have been properly set, the executive involved can obtain assistance in determining when, and what action to take to achieve real control.

This now defines our objectives. We have one or more of these objectives in mind when dealing with any given budget.

THE DIRECT LABOR BUDGET

The direct labor budget is one of the largest budgets for most manufacturing companies and it will be discussed first. It is probably the expense which is most susceptible to loss through lack of good standards and control. The magnitude of such loss to a company which has an inadequate cost control system is indicated by the fact that direct labor productivity is usually about 65% of standard production. (Figure 1). After the installation of a satisfactory control system, labor performance can be increased to 80% to 85% by moderately good management.

Good management, with diligent effort, can boost performance to 95 - 100% over a longer period of time.

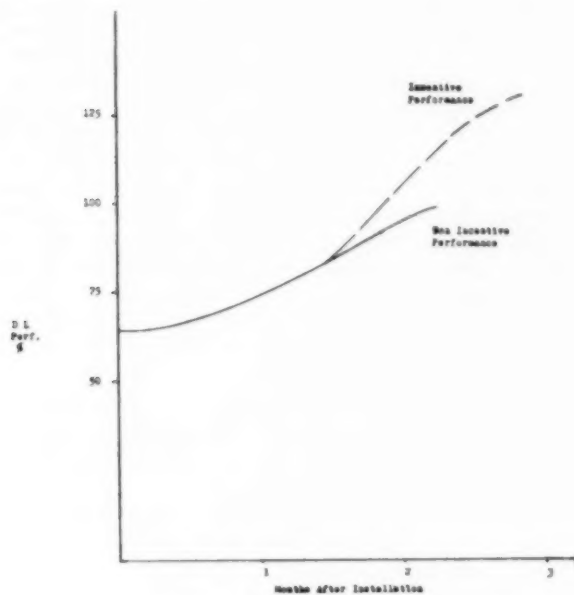


FIGURE 1

As shown in Figure 2, an increase from 65% to 100% in labor performance, results in a decrease in cost from 154 to 100, expressed as a percent of standard unit cost. Under a wage incentive system, productivity usually goes up over 130%, and budgets should be related to

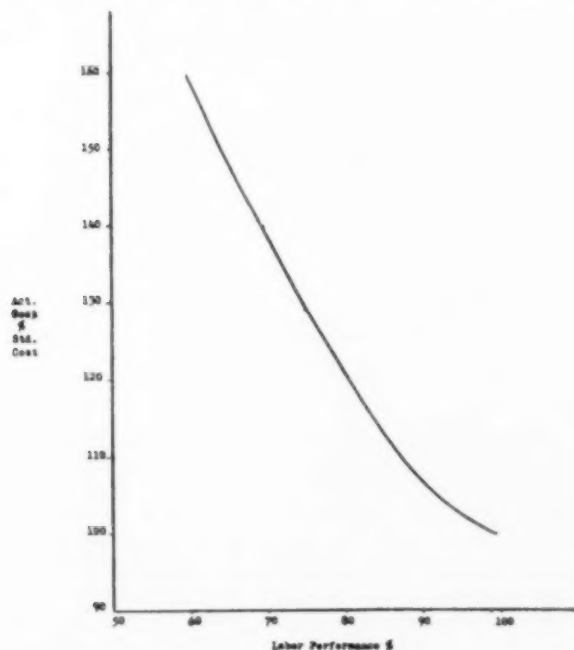


FIGURE 2

this output. Unit costs, however, are usually the same at all performances above 100% so that the direct labor budgeted per unit will be consistent and predictable.

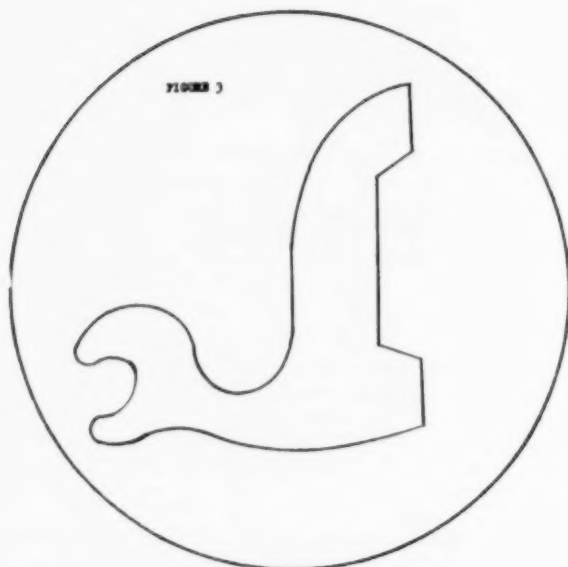
Usually, we set direct labor performance standards with a stop watch by observing and timing all elements of the operation for several cycles. One of the skills needed by the time study engineer is the ability to make an adjustment in the observed watch reading for fast or slow operators, to arrive at what is generally referred to as "normal" pace. "Normal pace" is a fairly common concept among engineers, and a satisfactory uniformity in the adjustment to normal pace exists so that standard times developed by different engineers observing different operators doing the same operation will be within necessary tolerances.

The standard time which is finally developed by the engineer includes an allowance for the operator's personal requirements and the normal time for all elements of work required. Sometimes, allowances must be included for operator's delays which cannot be avoided, but basically, standards represent work time.

Generally speaking, one of the most prevalent reasons for sub-standard labor performance is that the crew size is not properly balanced with the work load involved. There are two reasons for this:

1. Without proper analysis of the times required, a supervisor is inclined to be certain that there is enough manpower to get out the work required. This is natural because it is the easiest way for the supervisor.
2. An operator who has been assigned to a job involving idle time, must manage to appear to be busy at all times. The true amount of work involved can be determined only through time study.

For a company which manufactures products without variation, the setting of standard times is a fairly simple task. For those situations where there is a wide variation in the products, so that perhaps the products of no two jobs are alike, a different and slightly more complex system of data is required. Instead of developing standard times for products as may be done in the first situation, the standard times are established for the operations such as lathe or welding. They are expressed in terms of the product variables which cause the time to vary. Here (Figure 3) is an example of standard data which we have developed for one operation in the process of making dies for aluminum extrusions. The formula is:



Standard Minutes = 15.75 + 9.54 Holes + 6.60 Radius Inches
 + 4.44 Perimeter Inches + 1.60 Square Corners
 + 1.21 Ref. Lines

With this formula, a clerk can set a performance standard for a complete new die in a matter of minutes.

There is another way to set standards for labor which can be used for clerical and indirect labor as well as direct labor. It is a statistical method which involves making a large number of instantaneous random observations of an operation, and recording the condition of the operation at the time of observation. The "condition" may include such elements as "work", "necessary idle", "personal", "machine maintenance", etc. The percent of observations in which each of these conditions is noted, to the total number of observations, is taken as the "standard" for that condition. The true work involved is related to the volume at the particular time to obtain standards related to units. The larger the number of observations, the greater is the reliability of the data. Through statistical formula, the number of observations required to get standards accurate within $\pm 5\%$, for example, may be calculated. Under certain conditions, such standards may be as accurate as stop watch time studies.

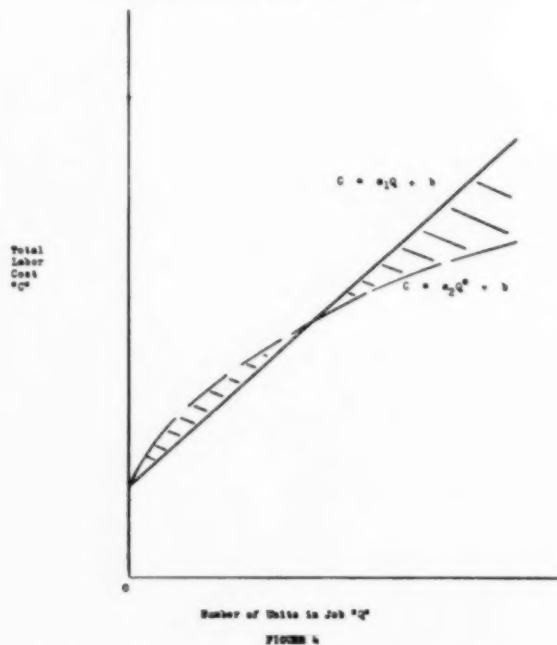
A factor which few companies, other than aircraft manufacturers, consider in setting standards is an improvement factor, or learning curve. The manifestation of such a factor is an actual decrease in unit time for each succeeding unit in a given job. More complex operations offer a greater opportunity for learning and thus greater improvement in unit time as the job progresses. A typical example of the common method of describing such a curve is to say "an eighty per cent learning curve". This says that the total average unit time on a job at any given stage of completion will be reduced by 20% each time the number of units completed is doubled. In

other words, if the average unit time for making 2 units is 1, the average unit time for making 4 units will be .80 and for 8 units, it will be .64.

The results of not taking the improvement factor into consideration are shown in Figure 4. The black line shows how most companies budget or quote the total job time by assuming that the average unit time is the same for any size job. This is not true. In the real situation, total job time will be a curved line as shown here by broken line. From the curve, it is clear what will happen to individual jobs. On small quantities, actual will tend to be above budget, and for larger quantities, actual will be below the budgeted amount. In the budget system alone, this may not be too important because of averaging of different jobs. In bidding, however, it may be highly significant.

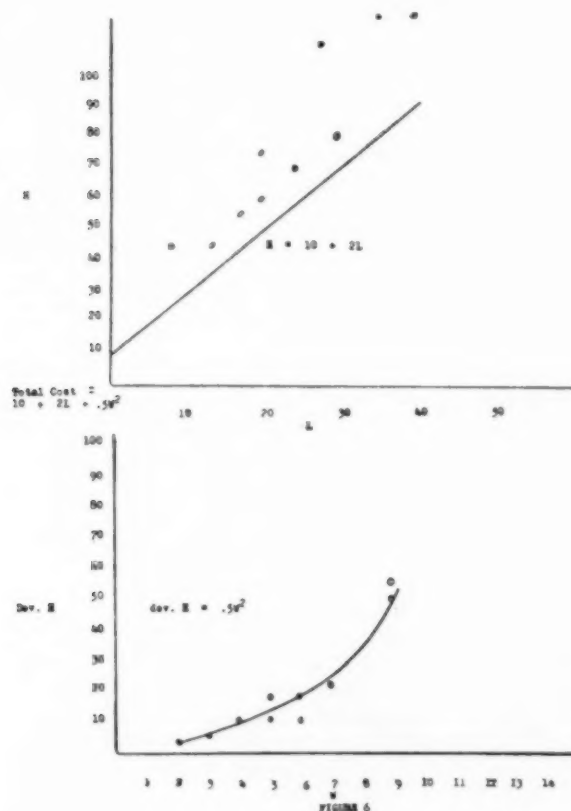
In practice, we can actually develop formula for total cost which reflect the improvement factor by analyzing jobs of various sizes. These formula are of the general form:

$C = aQ^e + b$ where C is the total cost for the job, Q is the number of units on the job and a , e and b are constants.



Occasionally, it is necessary to use past experience to develop budget allowances which will accurately predict costs during the time that the true standards are being developed. There is a way of doing this which will take into account the significant product variables that contribute to product cost. It can be done even though records of the time charged to jobs in the past has not been related to these variables. The use of this method and an idea of the technique involved can best be explained by a simplified example. The example chosen is the fabricating of an aluminum structure which

has 2 dimensions, L and W, which contribute to cost. We have the following data on past jobs: (Figure 6)



Item	Actual Fab. Hours	Width	Length
A	64.0	5'	20
B	56.5	6'	15
C	63.0	3'	25
D	123.5	9'	35
E	81.0	4'	30
F	71.0	7'	20
G	108.0	6'	40
H	99.5	9'	25
I	43.5	5'	10
J	43.5	2'	15

We will simplify this problem by going directly to the significant variable. A further simplification here over the usual actual case is that we have only two variables. Usually there are more, one of which would be quantity, as we have talked about under improvement factor. Our first step in determining how costs are affected by length and width is to plot total hours

against one of the variables. We shall choose length for our first try. We plot the points and see immediately that we have guessed correctly, in that there is a definite relationship between length and hours. It is clear enough so that we can express it mathematically as:

$$H = 10 + 2L$$

Many of the points we have plotted, however, miss our line by quite a bit. Because we are familiar with the process, we suspect that this is due to the fluctuations in the width, and our next move is to determine the effect of width. It is here that we do something a little out of the ordinary. We plot the *deviations*, rather than absolute value, from our first curve versus width.

Again we see an obvious relationship which can be expressed mathematically as, $dev. H = .5W^2$. Now by adding this expression to our previous one, we get an expression which predicts direct labor hours to make this product, based on past experience expressed in two variables. The complete formula for predicting hours is:

$$H = 10 + 2L + .5W^2$$

We could have as many variables in our expression as were important. In this particular case, you will see that we have actually reduced our variation so that all we have left are the random variations which are inherent in the process. This same technique is extremely valuable in forecasting and budgeting sales.

CONTROL ASPECTS OF BUDGETING

There are certain statistical procedures which have very fine potential for use in budgeting procedures. One such application involves the control aspect of budgeting and assists us in determining *when* variances from budgeted allowances are significant. This knowledge tells us when the corrective action is necessary. We obtain it by separating the variations in a value (sales or cost) which are due to chance, from those which are due to some known cause. By analyzing the chance variations, we learn their magnitude and their pattern. In fact, we can learn this well enough so that when actual values are reported on the budget, which are due to causes other than those which were predicted and which are outside the pattern of chance variation, a control chart such as is shown in Figure 9 provides an immediate indication, and we can recognize immediately that something *other* than chance has caused such variation. We then begin to seek such cause and take action to eliminate or perpetuate, depending on whether the variation was negative or positive in the direction of profit.

Figure 9 is a graphical presentation of the way this control system works for an expense item. This example might be the expense of replacing gas meters by a gas company. The en-

tire expense for the year is estimated on the basis of a statistical analysis of the life expectancy of meters, applied to the number of new meters placed in service in preceding years. This permits establishing the budget allowance for each budget period. It is not expected that the actual expense for replacing meters to be precisely equal to the allowance of each budget period.

It has been determined, however, that based on experience, this expense will be within a range represented by a specified upper limit and a lower limit, 99.7% of the time. As the year progresses and we find that actual expenses are at any value within these limits, no action is taken because it is known that these variances are due to chance. Any time that a value is outside of our limit, however, we begin to look for something to correct because we know that the value will be out of this area by chance only .003% of the time. Actually, we could set our probability limits at any point desired through the statistical procedures which we use.

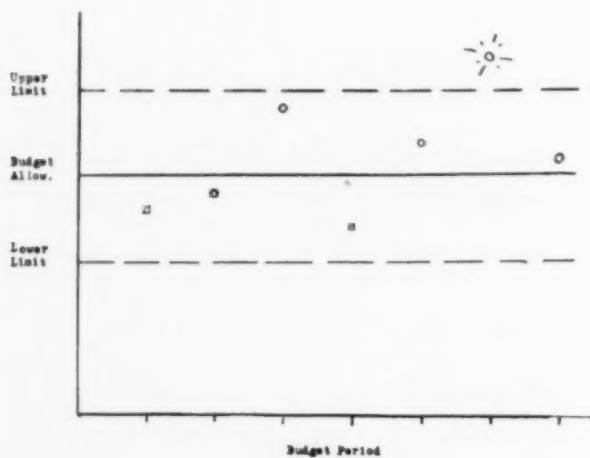


FIGURE 9

The same technique can be applied to the sales budget, to estimate the probability that "sales to date" figure indicates that the forecast of sales for the year should be revised.

THE INVENTORY BUDGET

Another budget where statistical methods are used is the inventory budget. For high value-low volume items, inventory control may be done by individual items. With increasing volume, however, inventory budgets require statistical controls. You are familiar with the general economical order quantity formula and other less rigorous methods of establishing order size.

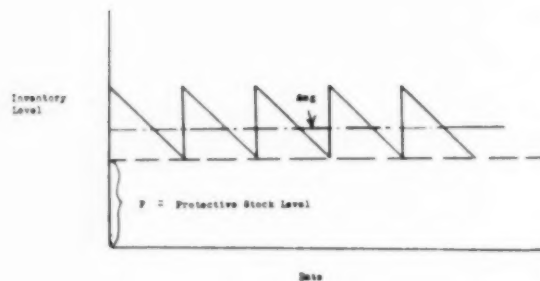
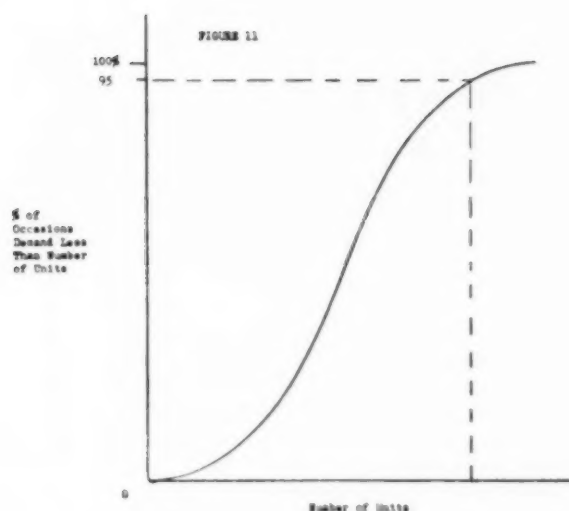


FIGURE 10

A diagram in Figure 10 of the usual inventory control program shows the inventory level varying between some level "P" and "P" plus the reorder quantity. This gives an average inventory level of "P" + 1/2 order quantity which we can budget for the entire class of inventory. Assuming that the proper level of inventory has been established for a given volume, future inventory levels should be budgeted so that they vary approximately as the square root of a change in the operating rate. That is, if the production rate is increased four times, the inventory level should only double in order to provide the same return on the investment.

A more troublesome problem, however, is establishing the level of "P". How high should it be? From the diagram, it is obvious that if our average usage during the time our order is being processed is always the same, "P" should be zero because it would never be required. Our usage during our reorder time does vary, however, and we are therefore obliged to keep a cushion of some kind, unless we are prepared to run out of inventory 50% of the times during which we have an order out with the vendor. On the other hand, if we make this cushion high enough so that we are absolutely sure that we will never run out, we will be budgeting a very large inventory.

The compromise that we frequently make, is to determine the inventory level which, when maintained as a cushion, will provide us with some assurance between 0 and 100 that we will not run out during the reorder time. A figure which is frequently chosen for the assurance factor is 95%. This says that our cushion will be maintained at a level which will be greater than our requirement during the reorder time 95% of the time. Conversely, our requirement during the replenishment time will be greater than this cushion 5% of the time. (Figure 11)



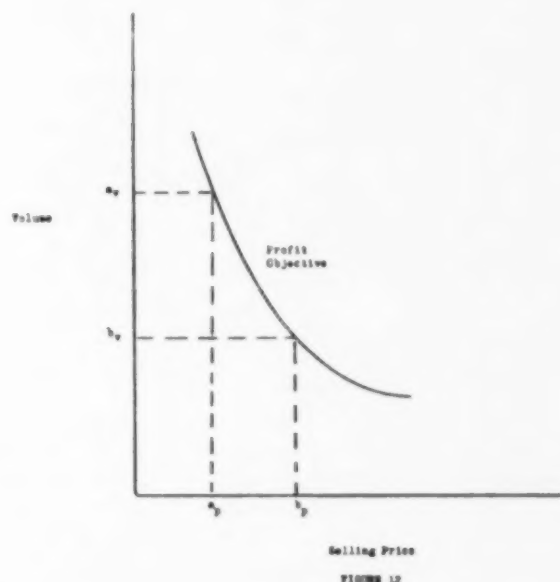
This risk is worth while, however, in view of the large reduction in inventory which is usually possible. A further refinement can be made which determines the assurance level that minimizes the total cost of carrying inventory and the cost of being out of inventory.

THE SALES BUDGET

The budgeting and planning of sales, and the setting of selling prices are very closely related and should be done concurrently. Figure 12 is a graphical presentation which is very useful in showing the relationship between these functions. This curve is an iso-profit line representing the profit objective of a company in terms of dollars of profit per period. This objective may be achieved at any combination of price and volume which is found on this curve.

To budget or plan for this profit objective requires that this volume--selling price combination also be budgeted. This type of analysis naturally requires a differentiation between

fixed costs and variable costs, but this is not objectionable since such a distinction should be made anyway, for pricing and for the greatest accuracy in budgeting costs for varying rates of operation.



There are other interesting budgets, such as cash and capital expenditure, and of course other techniques which I am sure you would find interesting. I believe, however, that we have covered a good sample of such techniques. If my explanations have made some of them seem cumbersome or laborious, I would like to say that in the places where I have used them, they have been successful. Also, there is a great deal of satisfaction in watching well developed budget allowances accurately predict good performance, not to mention how readily they develop the confidence of the people involved.

*Thank God our time is now when wrong
Comes up to face us everywhere,
Never to leave us till we take
The longest stride of soul men ever took.
Affairs are now soul size.*

- CHRISTOPHER FRY



By: Dr. Donald L. Kirkpatrick
Assistant Director
Management Institute
The University of Wisconsin

Tributes to the Milwaukee Chapter seem to occur rather frequently in these pages, but then maybe that's because they do so much for NSBB that we seem constantly indebted to them — then again maybe it's because they let us know what they are doing to promote budgeting in general and NSBB specifically. In any event, we consider it a privilege to publish the following article written by a beneficiary of the work performed by Milwaukee Chapter members.

We believe NSBB grows in stature with each successful assistance to an educational institution, and we know that these actions will insure NSBB's growth among the young and important men about to enter the business fraternity.

Perhaps this article could serve as a guide to the Educational Chairman of each chapter, and where we are not providing similar help to Colleges and Universities in the chapter territory, we can utilize this article to stimulate them to action.

NSBB Assists The University of Wisconsin

In 1954, I had the pleasure of attending an evening dinner meeting of the Milwaukee Chapter of the National Society for Business Budgeting. I was very much impressed by two things that took place at that meeting. First of all, there was an eagerness to learn new budget techniques as well as the ways in which budget problems were handled in other companies. Secondly, there was an equal amount of enthusiasm for helping other people who are active in budgeting. Those who had more experience were anxious to describe their accomplishments, disappointments, and suggestions to the others.

These motivations were implemented in the format of the meeting itself. Only half of the meeting was devoted to presentation; the other half was devoted to free and open discussion where ideas were exchanged and challenged. I couldn't help but contrast this with many of the dinner meetings of other professional and trade groups. At many of them, the main reason for attendance is the social function that takes place prior to and following the meeting. The speaker and the program seem only incidental.

Because of the attitude and approach of the Milwaukee Chapter of NSBB, we at the Management Institute of The University of Wisconsin were anxious to work with them. The President and Chairman of the Education Committee of the Milwaukee Chapter were equally anxious to see this co-operation take place.

The Management Institute of The University of Wisconsin has been offering 1-5 day institutes and conferences for management persons since 1944. Beginning with an Institute on "Human Relations for Foremen" the program has expanded to cover all levels and functions of management. During 1957-58, more than 5,550 persons from 1,444 companies in 27 states and 4 foreign countries attended one or more of the programs.

The motto of The Management Institute is "Progress with Stability", and quality programs at low cost continue to be offered. Conference leaders are carefully selected from universities, business and industry, and consulting firms in order to present a combination of theory and practical application. Enrollments in each pro-

gram are limited in order to provide for maximum group participation.

Beginning in April, 1958 all programs are presented in the beautiful new "Wisconsin Center." This modern, \$2,500,000.00 building was built with funds contributed by businesses, industries and individuals who are anxious to have MI and other University of Wisconsin departments offer their programs in the finest facilities.

In line with the MI policy of working with organized groups wherever possible, an effort was made to cooperate with the Milwaukee Chapter of NSBB. The results of this cooperation began to bear fruit in the Spring of 1954. Since that time, seven joint programs have been presented with a total of 230 persons in attendance. The Management Institute has provided the facilities, the "know-how" on how to run effective meetings, and the publicity for the meetings. The NSBB Milwaukee Chapter has suggested subject areas and provided qualified leaders. This combination has resulted in very successful programs which have been well received by enrollees.

WORKSHOP ON BUDGET TECHNIQUES

The first program that was offered as a joint venture took place in March of 1955. Subjects were suggested by the Educational Committee of the Milwaukee Chapter, and all of the conference leaders except one were members of that Chapter. Since that date, a similar workshop has been offered each year. Based on experience, subjects have been revised and leaders have been changed. Needless to say, we have seen a steady improvement in the speaking and conference-leading abilities of the NSBB members who have participated.

The program scheduled for February 10-12, 1959 is the outgrowth of these revisions and improvements. It is listed below:

TUESDAY, FEBRUARY 10

1. *Fundamentals of Budgeting*
Discussion Leader: Joseph Grimm, Jr.,
Secretary & Director, Thiem Products, Inc.
Milwaukee, Wisconsin
2. *How to Construct Manufacturing Expense Budgets*
Discussion Leader: Earl Lenger, Treasurer,
Weber Waukesha Brewing Company,
Waukesha, Wisconsin
3. *Dinner Meeting*
Topic: BRAINSTORMING
Speaker: Donald L. Kirkpatrick, Asst. Director
The Management Institute

WEDNESDAY, FEBRUARY 11

1. *Sales Forecasting*
Discussion Leader: Paul W. Linton, Assistant
to the President,

S.C. Johnson & Son, Inc., Racine, Wisconsin

2. *Budgeting for Selling, Administrative, and Research Expenses*
Discussion Leader: Charles Zinsmaster,
Budget Director
The Parker Pen Company, Janesville, Wis.
3. *Budgeting the Profit and Loss Statement*
Discussion Leader: Robert L. Knetzger, Budget
Supervisor,
Square D Company, Milwaukee, Wisconsin
4. *Balance Sheet Budgeting and Cash Forecasting*
Discussion Leader: Carl A. Koller, Asst. Mgr.
Budget Department, Allis-Chalmers Manu-
facturing Company Milwaukee, Wisconsin

THURSDAY, FEBRUARY 12

1. *Breakeven Analysis*
Discussion Leader: Ernst M. Krell, Supervisor
of Cost Control, Giddings and Lewis Machine
Tool Company, Fond Du Lac, Wisconsin
2. *Return on Investment*
Discussion Leader: William D. McGuire, Mgr.
Long-Range Analysis Department, Kimberly-
Clark Corporation, Neenah, Wisconsin.
3. *Long Range Planning*
Discussion Leader: William D. McGuire

This Budget Techniques Workshop is scheduled to be offered in the Spring of every year. Based on successful experiences in the past, the subjects will be basically the same as offered in the 1959 program. The leaders will be selected from the Milwaukee Chapter of NSBB. This well coordinated and well integrated workshop has proved to be very popular at The University of Wisconsin. Enrollees have come from Wisconsin, Illinois, Minnesota, Iowa and Indiana. The maximum enrollment of 28 persons has been reached every year, and an equivalent number have been turned away.

The term "workshop" literally describes what takes place at this 3-day program. The leaders come to the meeting well prepared to present new material, and to involve the group in workshop activities. The combination of presentation, visual aids, discussion, and group activities in making charts, graphs, and statements has given the enrollees knowledge, understanding, and skills that they were able to apply in their own companies. The workshops have been evaluated through comment sheets completed at the close of each program, and by means of a followup survey to enrollees of the 1956 workshop. The results of these evaluations have proved that the workshop has provided a much-needed service.

TWO-DAY CONFERENCE FOR FINANCIAL MANAGERS

Because of the success of the Budget Techniques Workshop described above, The Management Institute asked the Milwaukee Chapter to

cooperate on a 2-day Conference scheduled for October, 1958. This program was designed for controllers, treasurers, and others with interests and responsibility in the field of budgeting. Again, the subjects and leaders were selected by the Educational Committee of the Milwaukee Chapter. The Management Institute coordinated the program and promoted it so that the program would be tailored to the needs of those in attendance. The first day was devoted to a basic approach. The second day was aimed at experienced budget personnel, and covered advanced subjects which warranted special attention. The title for the Conference was "Preparing The Operating Budget and Cash Forecasting". The schedule for the two-day program is listed below:

OCTOBER 22 - Basic Approach

Chairman: Jerome C. Schraa, Budget Coordinator, Safeway Steel Products, Inc., Milwaukee, and Vice President, Milwaukee Chapter, NSBB.

1. *Fundamentals of Budgeting & Budget Techniques*
Leader: Joseph Grimm, Jr., Secretary, Thiem Products, Milwaukee
2. *Budgeting the Profit and Loss Statement*
Leader: Robert L. Knetzger, Budget Supervisor, Industrial Controller Division, Square D Company, Milwaukee
3. *Balance Sheet Budgeting and Cash Forecasting*
Leader: Carl A. Koller, Assistant Manager, Budget Department, Allis-Chalmers Manufacturing Company, West Allis.

OCTOBER 23 - Advanced Approach

Chairman: R.D. Bart, Comptroller and Assistant Treasurer, West Bend Aluminum Company, West Bend and President, Milwaukee Chapter, NSBB

1. *Pitfalls to Avoid in Cash Forecasting*
Leader: Leo F. Neitzel, manager, Budget Department, Allis-Chalmers Manufacturing Company, West Allis
2. *Administrative Expense Budget-Fixed or Variable*
Leader: Warner A. Knobe, Comptroller, Hevi-Duty Electric Company, Milwaukee
3. *The Case For Budgeting Profit By Product*
Leader: Harold C. Mason, Controller, S.C. Johnson & Son, Inc., Racine
4. *Coping With The Product Mix Problem*
Leader: William D. McGuire, Long-Range Analysis Department, Kimberly-Clark Corporation, Neenah

This two-day conference proved to be highly successful in terms of attendance. On the first day, 45 persons attended representing various sizes and types of companies from Wisconsin,

Iowa, Illinois, Indiana and Minnesota. The second day, 35 controllers, treasurers and budget directors attended from the same geographical areas.

The evaluation sheets that were completed by enrollees indicated a highly favorable reaction. They expressed such comments as: "excellent coverage" - "liked the workshop approach" - "very practical", and "speakers were well qualified".

SUMMARY

And so we at The Management Institute of The University of Wisconsin continue to cooperate with the Milwaukee Chapter of NSBB in presenting quality programs for persons interested in budgeting. The last four years of working together have resulted in seven successful programs. Members of the Milwaukee Chapter have been most willing to devote their time and effort to this project. The leaders have been eager to relate their own experiences, and to help the enrollees apply the principles and techniques in their own companies. Based on written comments and evaluations, we know that these programs have been very well received and effective in improving the budget techniques used by the companies represented.

We understand that one of the principal objectives of NSBB is to "make available to educational institutions information collected from its members and from its research activities." Certainly this objective has been carried out by the Milwaukee Chapter of NSBB in assisting The University of Wisconsin to present practical programs in the field of budgeting. It is our sincere hope that other universities throughout the country will find NSBB Chapters which are willing to offer advice, service, and conference leaders to further the education of persons active in budgeting.

Postscript to Doctor Donald L. Kirkpatrick's article, "NSBB assists the University of Wisconsin".

As one of the discussion leaders, I would like to add that we members of the NSBB are experiencing substantial benefits from our participation in the University's project. Open discussions at the workshop and conference meetings with people from many industries help broaden our view of problems and requirements in the field of profit planning. Through experience, we learn to improve our presentations, which helps us back home where selling a point to management is a delicate, and perhaps the crucial, face of our job. Also, there is pride and satisfaction in joining hands with the University on a project which is devoted to progress in business management, and through which an ever increasing number of people are acquainted with the goals of the NSBB.

Ernst M. Krell

NEW CHAPTER



KANSAS CITY, MISSOURI is the latest addition to the NSBB family. A total of twenty charter members have applied for membership under the leadership of a member-at-large, STEWART MITCHELL of Allstate Insurance Company. The charter presentation will take place early in March, but in the meantime we wish to send along the best wishes for success from all the present NSBB Members.

CHARTER MEMBERS

DONALD W. BOSWELL
R. W. BRACKEN
J. L. BROWNLEE
DALE L. ENGEL
RAY GALYON
ELDON O. GILLESPIE
J. W. GIPSON
BRUCE GRIMES
ALBERT A. HATHMAN
ROYAL W. HOLMAN
FRANK E. LONCAR
WARREN L. MCCOOK
ARNAUD S. MICHEL
STEWART F. MITCHELL
ROBERT F. NIEMANN
MAX F. POINTER
H. H. ROHRS
FRITZ E. RUEDEBUSCH
WESLEY M. SMITH
J. KENNETH STOW

Ernst & Ernst
Trans World Airlines, Inc.
City of Kansas City
Seidlitz Paint & Varnish Co.
The Marley Company
Consumers Cooperative Association
Marsh Steel Corp.
Allied Laboratories, Inc.
The H. D. Lee Company, Inc.
Allstate Insurance Company
The Vendo Company
Arthur Anderson & Company
Hallmark Cards, Inc.
Allstate Insurance Company
Real-Kill Company
Butler Mfg. Co.
Montgomery Ward & Co.
Western Auto Supply Co.
Real-Kill Company
Montgomery Ward & Co.

Kansas City, Mo.
Kansas City, Mo.
Kansas City, Mo.
Kansas City, Mo.
Kansas City, Mo.
Kansas City, Mo.
North Kansas City, Mo.
Kansas City, Mo.
Kansas City, Mo.
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Kansas City, Mo.
Kansas City, Mo.

By: R. Burt Gookin
Comptroller
H.J. Heinz Company
Pittsburgh, Pa.

ADVERTISING BUDGETING FOR PROFIT: THE COMPTROLLER'S CONTRIBUTION*

The H. J. Heinz case history, which follows, forcibly brings home the point that unless advertising is an integral part of the overall management function, it cannot contribute effectively to the company's profit objective. And it goes without saying that the primary purpose of all division budgets -- including advertising -- is to meet this profit objective.

There are many scales for measuring advertising success, but few of them seem to take into account the entire picture of a company's operations. Mr. Gookin analyzes the sales, selling effort, cost-of-sales and net profit relationships for 12 companies in the food processing field. These analyses chart the effect of advertising and other selling expenses upon sales and profits.

An important point I want to emphasize here is: It is time for all American business to call the advertising manager into the management conference room. Advertising is no longer the instrument of management; it is an integral part of management. Until that fact is realized, we are going to continue to see "successful" advertising accompanied by unsuccessful selling.

It is no great revelation to say that the fundamental purpose of a business organization is to make a profit. That much should be obvious. It is a fact, though, that many companies lose sight of that fundamental purpose. Large and medium-sized companies, in particular, can allow the complexities of operation to obscure the profit objective. These complexities take the form of responsibility to stockholders for dividends -- responsibility to employees for adequate earnings and as much stability in employment as possible -- participation in community activities in areas in which the company operates -- and contributions to charitable and educational projects.

All of these pursuits are commendable, and they are partially responsible for the increasingly good reputation of American business. The hard fact remains, though, that no company can serve its stockholders, its employees, its community, or any other group unless the company earns a satisfactory profit.

It is the primary purpose of management planning and control to ensure an adequate profit.

Among the activities classified under planning and control are:

- Company organization structure
- Employee training programs
- Levels of decision making
- Getting and keeping support for the company's overall program
- Establishment of long-term goals and shorter-term operating plans in the areas of marketing, sales, production, materials, labor, operation and administration expenses, cash position, inventories, purchasing and capital investments
- Analyzing and interpreting variations from the plan
- Reporting variations to different management levels
- Accomplishing corrective action promptly

A DEFINITION OF PLANNING AND CONTROL

To state it more simply:

The planning function consists primarily of putting mistakes down on paper before they are made, and then throwing the paper (with the mistakes on it) away before making the final plans.

**Originally presented before the Second A.N.A. Advertising Accounting Seminar in New York City, and reprinted from the Advertising Management Guide Books Published by the Association of National Advertisers, 155 East 44th Street, New York 17, N.Y. Information concerning the advertising budget section may be obtained by writing to the address shown.*

The control function helps to take care of those mistakes that manage to get made in spite of the planning function. It compares both current and longer-term actual results against those anticipated in the plans, and then maintains or increases favorable deviations and promptly corrects unfavorable deviations.

The successful management planning and control function has three very important characteristics:

1. It includes all parts of the business in the program.
2. It establishes both long and short-term goals
3. It reduces plans to specific profit statements and actual results are compared against these statements.

With this rather brief background in mind, let's look at a few typical charts and statements that result from the management planning and control activity.

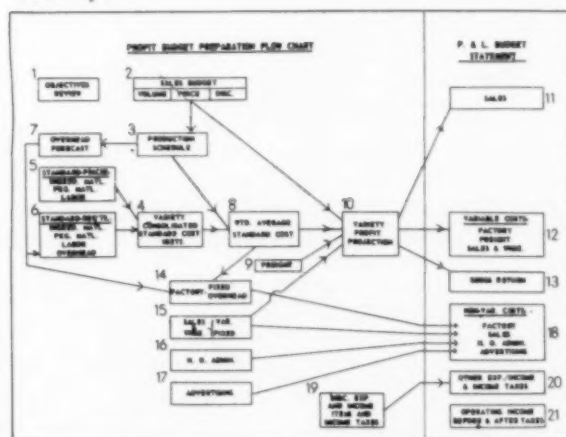


Chart 1

PROFIT BUDGET PREPARATION FLOW CHART

This chart makes a little better sense after you've lived with it a while. It isn't as complicated as it looks and I have no intention of tracing through all of the numbers, arrows, and boxes. This and the next few charts are from H.J. Heinz's program, but I believe they are fairly typical.

This flow chart diagrams the source information of profit plans, the inter-relationships of this information, and the final assembly of the material into a forecast profit statement. In short, this is a chart that tells how to collect and integrate information and how to put it together in planning for profit. In order to live with this chart, let's take it a piece at a time.

Preparation starts with a review of profit objectives -- in the past and in the longer-range future. Having taken your bearings, you then estab-

lish a specific goal for the year immediately ahead. All divisions of the business -- and that includes advertising and other promotion -- all divisions of the business then submit their tentative plans to meet the profit objective.

The sales budget, in terms of volume, price, and discount elements, is combined with inventory to develop the production schedule, which is basic to a determination of manufacturing overhead budgets.

Each production location estimates the cost elements of its required production, and all of these products go together into weighted average unit product costs.

Other divisions of the business -- sales, distribution, administration, and advertising -- prepare their estimates and submit them for inclusion in the profit forecast.

Now, suppose all this is done and you find that in spite of all the planning it doesn't look like you're going to meet your profit objective. When this happens -- it's back to the planning charts. You tug a little here and pull a little there, and finally attain a satisfactory projected profit. Although this may seem to be a hard way to do the job, I'm sure that satisfactory profit results are harder to obtain without careful planning.

This particular type of profit statement groups costs as variable or non-variable. The variable costs are approximately constant per unit, and hence go up or down with volume. An example of that might be the cost of tomatoes for tomato soup. Non-variable costs have the characteristic of being set as a definite dollar amount, these dollars being spent over the budget period almost without regard to changes in sales volume. An example of that might be an investment in a new labeling machine -- or an advertising budget. This segregation of costs simplifies profit calculations at different volume levels, as will be illustrated in the next statement.

The flow chart satisfies these two requirements of effective management planning and control:

1. The profit forecast reflects detailed planning by every division of the business.
2. These divisional plans are assembled together into a very specific profit goal.

COMPARISON OF CURRENT ACTUAL PROFIT RESULTS AGAINST ORIGINAL PLANS

We now leave the never-never land of planning and enter the cold, realistic world of control. The comparisons on Chart No. 2 show what you get into when you start applying control against the original current-profit plan. Here are a few of the highlights. In this statement form, the same

segregation of variable and non-variable costs is used as on the profit projection. Chart No. 2 shows the actual results achieved after a six-month period, along with total variance from the profit plan. (The original plan is not shown here -- only the variance.)

ACTUAL PROFIT VS. BUDGET - 6 MONTHS ENDED OCTOBER, 19 --						
	ACTUAL	TOTAL	%	VOLUME	PRICE	COST
BRANCH SALES AT CASHLOAD	\$ 6,798	(198)	(2.9)	(198)	(50)	-
ORDER SIZE & SOME MARK UP	374	(81)	(9.7)	(7)	(44)	-
SPEC. ALLOW. & CASH DISCOUNT	(1,117)					-
NET SALES	5,055	(374)	(7.4)	(374)	(65)	-
STG. FACTORY VARIABLE COST	3,987	101	2.5	101	-	-
FREIGHT	300	14	3.5	14	-	-
SALES & MISC.	128	3	2.3	3	-	-
	5,415	118	2.3	118	-	-
GROSS RETURN AT STANDARD	2,314	(98)	(3.9)	(98)	(88)	-
MATERIAL PRICE VARIANCE	100	100	-	-	-	100
MATERIAL USAGE	79	79	-	-	-	79
DIRECT LABOR	13	13	-	-	-	13
FACT. OVRD. ABSORPTION	10	10	-	(40)	-	50
FACTORY MISC.	11	11	-	-	-	11
FREIGHT & MISC.	34	34	-	34	-	34
	3,469	169	7.2	(47)	(88)	265
ACTUAL GROSS RETURN	624	36	7.8	11	-	35
FACTORY NON-VARIABLE EXP.	712	(19)	(1.4)	-	-	(19)
SALES	399	19	5.7	-	-	19
ADMIN.	440	-	-	-	-	-
ADVERTISING	1,081	41	3.7	11	-	31
SALES INCOME	360	26	6.2	(8)	(88)	319
OTHER REVENUE INCOME	- 47	(3)	(1.8)	-	-	(3)
NET INCOME BEFORE TAX	313	23	7.7	(76)	(88)	137
PROVISION FOR TAX	307	(16)	(5.2)	-	-	-
NET INCOME AFTER TAX	56	7	12.7	-	-	-

() Denotes red figures

Chart 2

These variances are then broken down among the factors that have major influences on profit -- namely, variances in physical volume, in unit selling prices, and in unit costs or spending. For example, sales are unfavorable by \$210,000 or 3 percent, which is due to a minus variance of \$157,000 in physical volume and \$53,000 in selling price. In other words, for this period the company sold less than it expected to sell, and got less than it expected for what it did sell. However, there were savings in other areas so the result was a favorable profit variance. That's doing it the hard way.

Of course, this overall statement is backed up by detailed schedules for each variance which cover geographical and product differences. When you present these results to all the division heads of your business, and when the reasons for variances are discussed, you have a realistic, specific and objective basis for keeping actual profit results equal to or better than original plans. Another advantage of such reviews is that they provide flexibility, making it possible to change to more profitable plans as new ideas are developed and opportunities arise.

Now, let's turn to two other statements that deal with the longer-range aspects of planning

FIVE-YEAR PROFIT PLANS

Chart No. 3 shows four years of actual profits in condensed profit statement form, and five years of projected profits. The thinking behind these plans deals with the longer-term rate of growth and the relationship of both variable and non-variable costs to sales, of which advertising is a most important part. These factors all net

down to the effect on profit dollars and profit percent. Items in the lower half of the statement are other important measures of investment and profit results -- current ratio, plant and equipment investment, profit return on all funds invested, and inventory. Consideration of these factors rounds out the longer-range profit plans. The important feature of this longer-term planning appears to be the indication of the kind of sales growth that must be attained, and the advertising costs and other cost and expense relationships that must be maintained to get the planned profit results.

FIVE-YEAR CASH PLANS

The upper portion of Chart No. 4 shows asset and liability items for four actual and five projected years. From these figures are developed the source and use of cash funds shown in the lower half of the statement. The indicated need for cash and use of such cash funds are, of course, vital considerations in the successful and continued operation of every business.

HOW THESE FUNCTIONS INFLUENCE ADVERTISING ADMINISTRATION

Now let's consider how these functions influence advertising administration. I hope it is clear from this discussion that advertising planning and control must be an integral part of the overall management function. Like every other cost, the amount to be spent for advertising must fit into the long-range profit plan. The question of how much to spend for advertising inevitably leads to the question of what that advertising dollar buys.

Mr. Keith Powlison wrote an article for the Harvard Business Review on a subject closely related to this one. He said: "A company cannot stand still. If it stops growing, it starts going down hill; there is no in-between. That is part and parcel of the dynamic nature of business."

I believe that advertising is one of the most important driving forces in business growth. I believe, therefore, that it is a very important part of the total management planning and control function to determine how much to spend on advertising and to measure how effective that advertising is.

There are many scales for measuring advertising success, but few of them seem to take into account the entire picture of a company's operations. I would like to lay before you a method that may help gauge the effectiveness of your advertising in the context of everything else your organization does.

OPERATING INCOME FORECAST (FIGURES ARE ILLUSTRATIVE ONLY)																		
	P.Y. 1952		P.Y. 1953		P.Y. 1954		P.Y. 1955 (EST.)		P.Y. 1956 BUDGET		P.Y. 1957		P.Y. 1958		P.Y. 1959		P.Y. 1960	
	DOLLARS	%	DOLLARS	%	DOLLARS	%	DOLLARS	%	DOLLARS	%	DOLLARS	%	DOLLARS	%	DOLLARS	%	DOLLARS	%
NET SALES	2805	100.0	2894	100.0	2992	100.0	2672	100.0	2776	100.0	2796	100.0	2866	100.0	2945	100.0	3034	100.0
VARIABLE COSTS	2081	73.1	2062	71.2	1860	69.1	1727	64.6	1781	64.2	1781	63.7	1811	63.2	1847	62.7	1887	62.2
GROSS RETURN	754	26.9	832	28.8	832	30.9	945	35.4	995	35.8	1015	36.3	1055	36.8	1090	37.3	1147	37.8
NON-VARIABLE COSTS																		
MANUFACTURING	104	3.7	115	4.0	160	5.9	174	6.5	176	6.3								
BRANCH HOUSE	270	9.6	286	9.9	280	10.4	284	10.6	311	11.2								
GENERAL ADMIN.	182	6.6	184	6.4	180	6.0	187	6.9	111	4.0								
ADVERTISING	179	6.4	160	5.5	155	5.8	169	6.3	171	6.2								
M.P.S.U. PAYMENTS	6	.2	7	.3	7	.3	7	.3	6	.2								
TOTAL	661	23.6	672	23.3	711	26.4	741	27.8	775	27.9	786	28.1	811	28.3	839	28.5	871	28.7
SALES INCOME	93	3.3	160	5.5	121	4.5	204	7.6	220	7.9	229	8.2	244	8.5	259	8.8	276	9.1
NET INCOME AFTER TAX	54	1.9	70	2.4	51	1.9	83	3.1	82	2.9	78	2.7	92	3.2	109	3.7	127	4.2
NET WORKING CAPITAL	1026	36.3	999	34.3	989	36.4	1006	37.2	907	32.8	879	31.0	939	32.4	1023	34.3	1123	36.6
CURRENT RATIO	3.91		3.14		3.38		4.87		3.67		3.15		3.46		4.13		4.89	
AVG. VALUE PLANT & EQUIP.	660	23.4	736	25.2	757	27.9	756	27.9	808	29.3	895	31.6	938	32.0	921	30.9	894	29.1
AVG. INVESTMENT	1750	62.0	1788	60.3	1762	64.8	1764	65.3	1776	64.3	1790	63.5	1848	63.7	1913	64.1	1979	64.4
RETURN ON INVESTMENT	3.1%		4.0%		2.9%		3.6%		3.5%		4.2%		5.0%		5.7%		6.4%	
AVG. INVENTORY	943	33.4	1034	35.5	1097	40.4	1019	37.7	936	33.9	957	33.8	978	33.7	1002	33.6	1030	33.6
AVG. ASSETS EMPLOYED	3078	79.5	3168	74.4	2211	81.4	2189	78.0	2075	75.1	2172	76.7	2346	77.4	2174	76.2	2267	74.4

Chart 3

BALANCE SHEET FORECAST (FIGURES ARE ILLUSTRATIVE ONLY)									
	P.Y. 1952	P.Y. 1953	P.Y. 1954	ESTIMATED P.Y. 1955	BUDGET P.Y. 1956	P.Y. 1957	P.Y. 1958	P.Y. 1959	P.Y. 1960
ASSETS									
CASH AND SECURITIES	154	113	129	98	94				
RECEIVABLES	229	220	171	280	204				
INVENTORIES	964	1162	1093	946	959				
PREPAID ITEMS	29	31	28	22	22				
TOTAL CURRENT	1376	1466	1419	1266	1269	1286	1221	1250	1415
NET-PROPERTY AND EQUIP.	798	754	750	791	868	924	932	916	877
MISC. FIXED ASSETS	9	11	11	11	11	11	11	11	11
TOTAL ASSETS - U.S.A.	2183	2231	2180	2058	2122	2221	2164	2177	2303
INVESTMENT - AFFILIATES	184	191	192	204	204	204	204	204	204
ADJUSTED TOTAL ASSETS	2367	2422	2372	2262	2326	2425	2368	2381	2507
LIABILITIES									
CURRENT NOTES	90	190	210	10	90	150	117	58	10
PAYABLES	102	96	86	85	84				
MISC. ACCRUALS	168	180	154	185	188				
TOTAL CURRENT	360	466	450	260	359	400	302	177	104
LONG TERM OBLIGATIONS	365	357	345	343	358	327	312	296	280
EQUITY - U.S.A. OPERATIONS	1388	1408	1415	1425	1448	1486	1486	1486	1486
TOTAL LIABILITIES - U.S.A.	2113	2231	2190	2028	2122	2221	2164	2177	2303
INDEBTEDNESS	27	26	25	24	23	19	13	9	4
EQUITY - AFFILIATES	187	163	167	182	180	188	193	198	201
ADJUSTED TOTAL LIABILITIES	2289	2422	2382	2234	2326	2427	2370	2387	2509
SOURCE OF FUNDS									
NET INCOME - U.S.A. OPER.	84	70	81	69	62	74	92	109	127
NET DIVIDENDS - AFFILIATES	27	33	30	32	37	42	43	44	45
DEPRECIATION-DEFERRED EXP.	42	48	50	52	54	57	59	61	64
TEMPORARY FINANCING	-	-	-	-	-	60	(60)	(60)	(60)
MISC. (INCL. FOREIGN SALES)	2	1	3	1	1	1	1	1	1
TOTAL	155	151	157	153	204	234	256	277	297
USE OF FUNDS									
DIVIDENDS TO STOCKHOLDERS	62	67	67	67	67	67	70	70	70
RETIREMENT OF STOCK	4	4	4	4	4	4	4	4	4
REDUCE LONG TERM DEBT	(1)	8	13	2	8	8	18	16	16
INVESTMENT - AFFILIATES	4	8	2	18	1	8	8	8	4
INCREASE NET - WORKING CAPITAL	(111)	(27)	(18)	17	(19)	23	21	24	40
PURCHASE FIXED ASSETS	187	80	89	48	179	116	83	80	51
INTERNATIONAL OFFICE EXP. - NET	19	6	4	3	4	3	3	3	3
TOTAL	128	131	137	131	226	236	256	277	297

() Denotes red figures

Chart 4

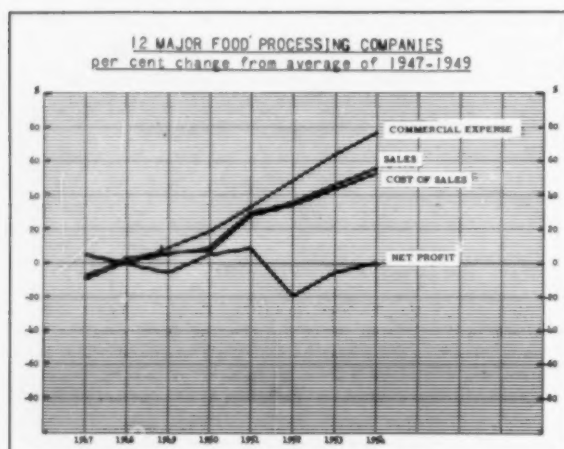


Chart 5

Chart No. 5 shows trend information taken from published reports for twelve major food processing companies, including H. J. Heinz. It covers the eight years from 1947 through 1954. It shows four items: sales, cost of sales, commercial expense, and net profit before income taxes. 1947-1949 was used as the base period. That is, 20 percentage points above the zero line on Chart No. 5 means a 20 percent improvement over the 1947-1949 average, and 20 points below the zero line, of course, represents a 20 percent drop from the three-year average. We see, then a 56 percent increase in sales for the eight-year period. Cost of sales has followed an approximately parallel course, and that is probably good, because it indicates that selling prices and manufacturing costs have been kept in reasonably sound relationship.

And lastly, the commercial expense, the highest line on the chart. This includes direct selling, administrative expense, and advertising. Because of the lack of detail available in published figures, these measurements must be on a rather broad basis. These expenses have grown about 78 percent over the base period. Net profit, on the other hand, has remained at about the same level throughout.

TYPICAL PROFIT SQUEEZE

This gives us a pretty accurate picture of a profit squeeze, in which a group of companies has had to run pretty hard just to stay in the same place. This profit squeeze is not confined to the food processing business, but is typical of a number of industries. It does reflect increased competitive conditions in the industry.

What is the answer here? I would say that this chart points up the necessity for increased man-

agement effort and ingenuity toward improving the effectiveness of commercial expense outlays. This example is based on industry averages.

CASE EXAMPLES OF INDIVIDUAL COMPANY FIGURES

Let's look at a few of the individual company figures on the same basis. These companies are not identified; however, I will tell you that H. J. Heinz is not among them.

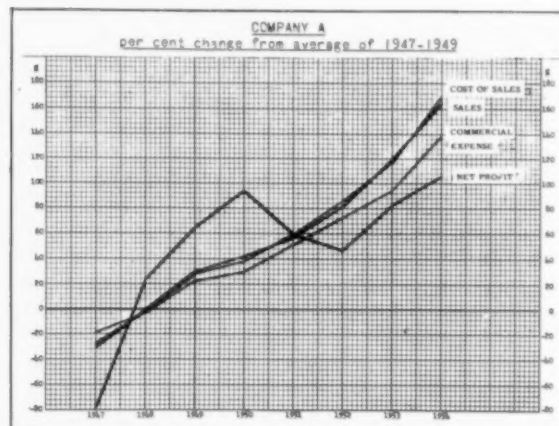


Chart 6

Company A as shown in Chart No. 6 has had a sales growth of 164 percent, with cost of sales following closely. Commercial expenses have increased by only 140 percent, and net profit has gone up 104 percent. That is good. Sales and profit performance are substantially better than the figures for the industry as a whole. It is obvious, too, that this company has found effective methods of spending its commercial expense dollars. Naturally, with a record like that, some other company or companies must be doing something to keep the industry average down.

Here is Company B. It has had a sales growth of only 42 percent and a commercial expense

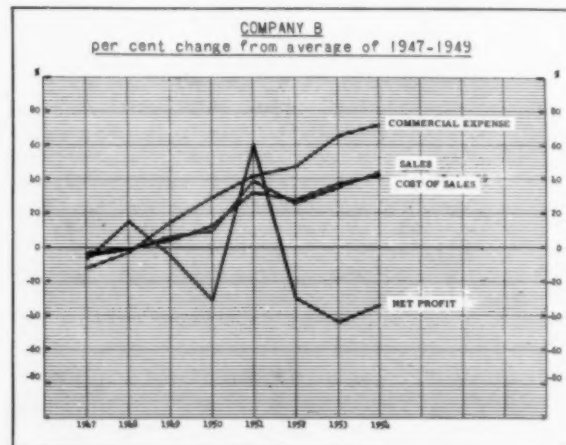


Chart 7

increase of 70 percent. In 1951 you see a sharp rise in net profit. Since then, however, commercial expense has continued to grow, while there has been no appreciable increase in sales. The result is a significant decrease in net profit.

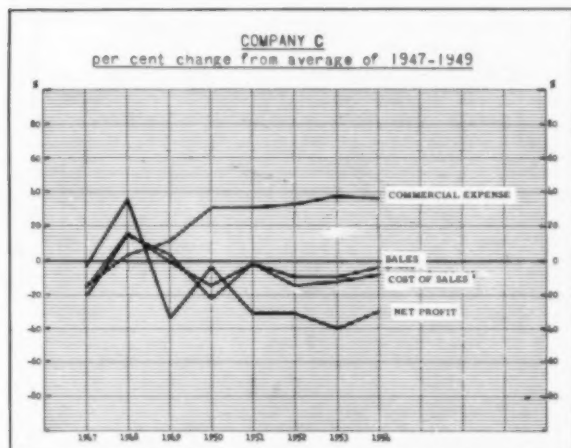


Chart 8

Here is Company C which arrived at the same destination via a different route. Company C has had no appreciable growth of sales -- a slight decline, in fact. Commercial expenses, on the other hand, increased by 35 percent with the result that net profit went down by about the same amount. The only thing you can say for this picture is that it's been fairly constant for the last three years or so and maybe some day Company C will take another look at what has been going on.

The trouble with these examples is that they are real, and real examples are seldom perfect. Another trouble is that this information is necessarily on a rather broad basis. Let's take a look at a hypothetical example, one that we will call the Controller's Delight, as well as the Advertising Manager's.

This is Company X as shown in Chart No. 9. Company X has had a sales growth of 115 percent. Cost of sales has followed along nicely. Direct selling and administrative expenses have increased about 60 percent. There is a separate breakdown on advertising for Company X, and it shows an increase of 104 percent. The combination of these factors has improved net profits by 150 percent, which accounts for us calling this the Controller's Delight.

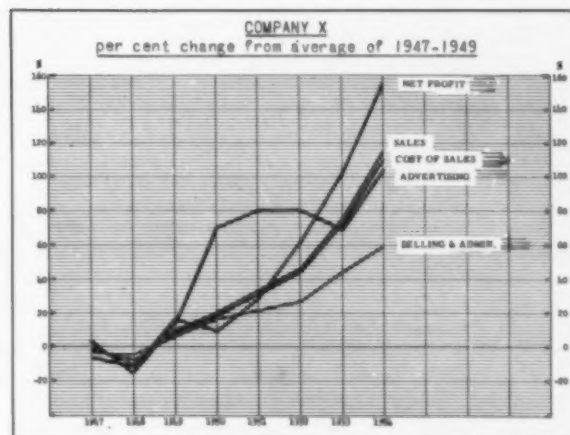


Chart 9

The left hand side of Chart No. 9 shows that sales growth of the company was no better than moderate for several years, and that advertising expenditures were increased sharply in 1950 in an effort to improve the sales picture. This program was successful in stepping up the rate of sales, and in the last year the advertising budget was again increased. That part of it is what delights the Advertising Manager.

MANAGEMENT PLANNING AND CONTROL IS A COMPANY-WIDE PROBLEM

I hope these examples will serve to prove that management planning and control is a company-wide problem. The solutions do not lie in advertising alone, or in cutting of production or administration costs, or in any other single factor. I hope that these examples will point up the importance of letting the advertising manager in on the planning and control function. To do so will permit him to perform better, and who knows? -- he might even be a frustrated controller.

I hope, too, that these examples will help point up one approach to better measurement of the effectiveness of your advertising. We should all try to learn the habit of looking at the advertising budget with one eye on the net profit picture. We may wind up a little crosseyed, but at least we won't be blind. It is as simple as this: we must be interested not only in how much we can sell, but in how much we have left. Otherwise, we are in danger of finding ourselves in the position of the surgeon with the successful operation and the defunct patient.



By: Charles H. Pinkham
Executive Vice-President
Chambers and Wiswell, Boston

EXACTLY HOW EFFECTIVE is your Advertising?*

You can find out with statistical accuracy, says author of this article. All you need are your monthly sales and advertising figures for as many years as they are available.

If advertising has played a major role in building your sales, the degree of its effectiveness can be measured with mathematical accuracy. All you need are your monthly sales and advertising figures for as many years as they are available.

Simply stated, our method is to find the average effectiveness of a company's advertising over a period of years and then express current effectiveness as a percentage of that average. In other words, we find the normal relation between advertising and sales and express the current relation as a deviation from the norm.

But before we can determine the average relation between advertising and sales we must manipulate our monthly advertising and sales figures so that:

1. we eliminate seasonal fluctuations
2. we include in our computations not only the current relation between advertising and sales but the percentage of increase or decrease in sales for the current period compared with the period preceding
3. we provide for a lag between advertising investments and resultant sales
4. we take into consideration the cumulative effect of advertising.

In explaining how our method works we will arbitrarily use an advertising investment that is about 50% of sales — not an unusually high percentage for such products as proprietary medicines.

MOVING TOTALS

The first step is to convert monthly sales and advertising figures to moving totals. The traditional statistical method for developing a 3-month moving total is to total 3 months' sales (January, February and March) and let the sum represent the moving total for the middle month (February). Then let the total of February, March and April represent the moving total for March, and so on. If you chart your monthly sales and then chart a 3-month moving total of your sales you will see that the moving total tends to smooth the monthly curve . . . to blunt or eliminate peaks or troughs.

We use 12-month moving totals only. We take, for example, sales for the year 1955 (12 months ending in December 1955). Then we total sales for the 12 months ending in January 1956, then the 12 months ending in February 1956, and so on. Instead of having the sum of a 12-month period represent the middle month we have it represent the last month. Thus each moving total represents sales for the preceding 12 months.

TWO OBJECTIVES

If you now chart 12-month moving sales totals you will accomplish two important objectives: eliminate seasonal fluctuations, develop a curve that shows the trend of your sales. Your moving-total figures each represent sales for the preceding 12-month period.

After converting monthly sales to 12-month moving totals do the same with monthly advertising figures.

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205 East 42nd Street, New York, New York*

Instead of comparing January advertising with January sales you can now compare advertising for 12 months ending in January with sales for 12 months ending in January. Thus you begin to make provision for the cumulative effect of advertising.

To some extent the conversion of monthly figures to 12-month moving totals provides for a normal lag between advertising and sales. However, if for a product there is a lag of two months between consumer advertising and factory sales, we merely set back our moving totals of advertising two months. We then compare 12 months of advertising for the period ending in November, 1955 with 12 months of sales for the period ending in January 1956.

CONVERSION TO PERCENTAGES

The next problem is how to take into consideration an increase or decrease in sales for any 12-month period compared with sales for the 12-month period one year preceding. This is done by converting 12-month total of "current" sales and advertising to percentages of sales for the period one year preceding.

Let us assume that sales for 1955 were \$1,000,000; that advertising investments for the 12-month period ending October 1956 were \$500,000; and that sales for 1956 were \$1,100,000. (We have provided for a two-month lag.) In converting these figures to percentages all we have to do is let 50% represent "current" advertising and let 110% represent "current" sales. We don't have to record that fact that the

preceding year's sales were 100% because for every "current" period the preceding year's sales will always be 100%.

After we have converted 12-month moving totals of advertising and 12-month moving totals of sales to percentage of sales for the 12-month period one year preceding, we are ready to find the normal relation between advertising and sales.

ADVERTISING-SALES RELATION

To better understand this relation, let us examine percentage figures for a fictitious company, making no allowance for an advertising lag:

ADVERTISING AND SALES FIGURES

12-month period ending:	% advertising to preceding 12-mo. sales	% sales to preceding 12-mo. sales
1956 Jan.	46	98
Feb.	52	104
Mar.	54	106
Apr.	56	107
May	55	106
June	49	99
July	46	96
Aug.	50	99
Sept.	47	98
Oct.	53	104
Nov.	51	103
Dec.	48	100

The figures above are in chronological order. Now let us rearrange them by advertising percentage in ascending numerical order. This will give us some idea of the relation between advertising investment and resultant sales. If advertising is a significant force in the creation of sales, when we increase the ad percentages there should be an upward trend in the sales percentages:

ADVERTISING AND SALES FIGURES IN NUMERICAL ORDER

12-month period ending:	% advertising to preceding 12-mo. sales	% sales to preceding 12-mo. sales
1956 Jan.	46	98
July	46	96
Sept.	47	98
Dec.	48	100
June	49	99
Aug.	50	99
Nov.	51	103
Feb.	52	104
Oct.	53	104
Mar.	54	106
May	55	106
Apr.	56	107

Figure 1

Scatter chart showing relation between advertising and sales

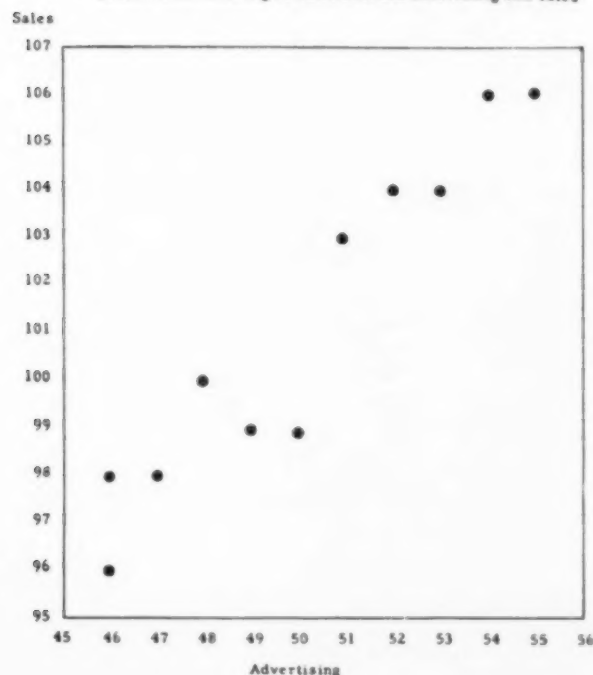
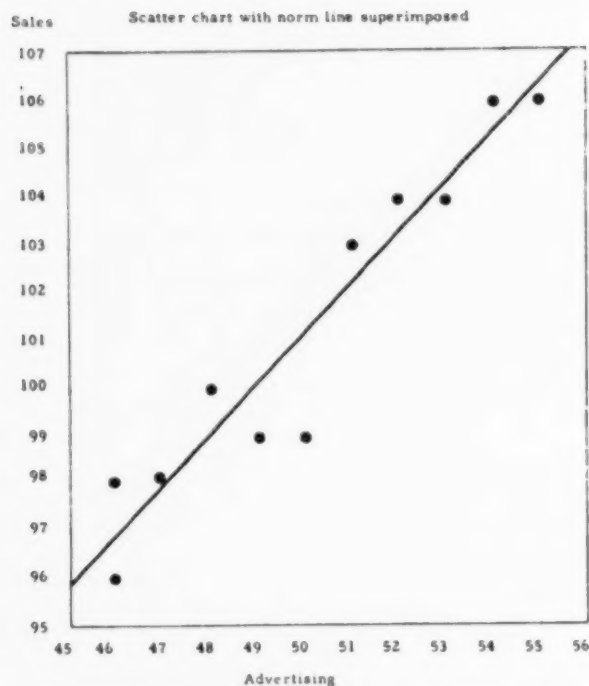


Figure 2



To visualize the correlation between advertising and sales, we next chart these two columns of figures on a scatter chart (Figure 1). The horizontal scale represents advertising percentages; the vertical scale represents sales percentages. Advertising and sales percentages are the coordinates of each dot and describe its location.

To determine the average relation between advertising and sales we draw a straight line (norm) diagonally across Figure 1 — a line that is closer to all of the dots than any other straight line we could draw. We establish the exact location and slope of this line by a statistical formula known as the method of least squares (Figure 2).

The line on Figure 2 — the norm line — is a graphic presentation of our yardstick for evaluating advertising effectiveness. The values on this line, expressed as percentages of sales for the 12-month period one year preceding, appear in the next table under the heading: Sales norm.

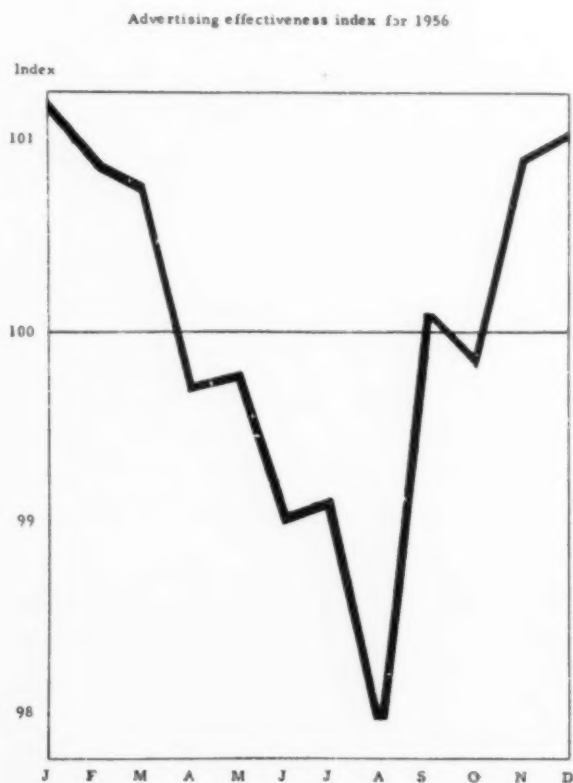
INDEX OF ADVERTISING EFFECTIVENESS

This table shows the steps we take to arrive at the evaluation of advertising effectiveness. We tabulate advertising, sales and sales norm — each expressed as a percentage of sales for the 12-month period one year preceding. The last column is the percentage of sales to the sales norm. This is the index of advertising effectiveness.

12-month period ending:	% advertising to preceding 12-mo. sales	% sales to preceding 12-mo. sales	Sales norm	% of advertising effectiveness
1956 Jan. . . .	46	98	96.87	101.17
Feb. . . .	52	104	103.14	100.83
Mar. . . .	54	106	105.23	100.73
Apr. . . .	56	107	107.32	99.70
May . . .	55	106	106.27	99.75
June . . .	49	99	100.00	99.00
July . . .	46	96	96.87	99.10
Aug. . . .	50	99	101.05	97.97
Sept. . . .	47	98	97.91	100.09
Oct. . . .	53	104	104.18	99.83
Nov. . . .	51	103	102.09	100.89
Dec. . . .	48	100	98.96	101.05

This index of advertising effectiveness tells us, for each preceding 12-month period, the percentage of the effectiveness of our advertising based on average effectiveness over a period of years.

Figure 3



In preparing the norm table it is best to use figures covering as long a period of time as possible. You can then evaluate the effectiveness of your advertising for as long as you have been in business.

You chart your index of advertising effectiveness in the manner shown in Figure 3.

METHOD SUMMARIZED

Let us review briefly the steps we took to arrive at the index of advertising effectiveness.

We started with 3 variables:

1. sales for a 12-month period
2. advertising for the same 12-month period
3. sales for the 12-month period one year preceding.

The problem was to eliminate two of these variables and yet express the inter-relation of all 3 by a single index. Variable 3 was given a value of 100% throughout the series. By expressing variables 1 and 2 as percentages of 3, the latter could be eliminated and we would maintain the interrelation of all 3 variables.

Then, by establishing the normal relation between variables 1 and 2 (the sales norm) and finding the deviation of actual sales from that norm, we ended up with an index of advertising effectiveness.

MANY APPLICATIONS

The foregoing method of measuring advertising effectiveness has been used to evaluate the advertising of many products, mostly packaged goods in the drug and grocery-products fields. It is currently being used to measure the effectiveness of advertising done by a re-up-

holsterer, a rug cleaner and by companies in the transportation and entertainment fields.

Remember this is not a measurement of advertising efficiency; it measures advertising effectiveness. Strikes, weather conditions and other factors beyond the control of the advertiser tend to increase or decrease the effectiveness of his advertising. The influence of such uncontrollable factors is reflected in the advertising-effectiveness index, as are such controllable factors as changes in price or distribution.

MEASURES CUMULATIVE EFFECT

The principal factor this method does eliminate is the volume of advertising investment. Even when one advertiser stopped advertising for 14 months (and sales fell off 30%), the index of advertising effectiveness still ran very close to normal; because for that product it is normal for sales to fall off 30% when advertising is cut out for that period of time. The index measured the cumulative effort of advertising when current advertising expenditures stopped.

Usually, when the advertising effectiveness index figures are charted, the curve follows somewhat the same general pattern as the sales curve. This is because effective advertising increases sales; and when sales increase the advertiser continues to spend a specified percentage of his sales for advertising. Consequently, as long as advertising is effective sales continue to rise.

*"This time, like all times,
is a very good one if we
but know what to do with it"*

Ralph Waldo Emerson



EUGENE R. LAUMAN — Senior Asst. Controller, Missouri Pacific Railroad Co., St. Louis, Mo.
ALBERT F. JOHANNSEN — Mgr. Management Services Div., Ernst & Ernst, St. Louis, Missouri
GEORGE K. WILLS — Sales, Profit and Cash Forecasting-Economic, Rohm & Haas Co., Philadelphia, Pennsylvania
JOSEPH C. BODNAR — Coordinator of Cost and Budgets, Lukens Steel Co., Coatesville, Pennsylvania
ERVIN S. PALMER — Budget Supervisor-Pacific Div., National Broadcasting Co., North Hollywood, Calif.
JAMES E. ETUE — Instructor, Henry Ford Community College, Livonia, Michigan
ROBERT R. BEHN — Controller, Lock Joint Pipe Co., East Orange, New Jersey
EDWARD BENSEN — Budget Supervisor, Tung-Sol Electric Inc., Newark, New Jersey
LESTER DESCHENES — Budget Analyst & Special Assignments, Federal Pacific Electric Co., Newark, New Jersey
AARON FINK — President, Essex Paper Box Mfg. Co., Inc., Newark, New Jersey
STUART FRAYNE NIMMO — Specialist — Management Advisory Services, Price Waterhouse & Co., Newark, New Jersey
FRED C. REINBOTT — Budget Administrator, Singer Mfg. Co., Elizabethport, F., New Jersey
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RALPH H. THATCHER — Budget Supervisor, General Dynamic Corp-Convair-Pomona, Pomona, Calif.
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MARVIN SCHENK — Budget Director, E. J. Brach & Sons, Chicago, Illinois
ALFRED H. BULKLEY — Budget Officer, U.S. Ordnance Ammunition Command, Joliet, Illinois
CHARLES W. CULLEN — Asst. Superintendent, Kankakee State Hospital, Kankakee, Illinois.
CHARLES L. HENDERSON — Business Mgr., Olivet Nazarene College, Kankakee, Illinois
MILTON LEWIS — Accountant, Personal Products Corp., Wilmington, Illinois
THOMAS G. WRIGHT — Asst. Chief Accountant Mill Acctg., American Steel & Wire-Div. U.S. Steel Corp., Joliet, Illinois.
CHARLES E. SASS — Chief Accountant, Personal Products Corp, Wilmington, Illinois
SAMUEL R. McCLURD, II — Dept. Supervisor-Budgets, Westinghouse Electric Corp. Williams-ville, New York
D.P. THOMPSON — Mgr. of Financial Control, Westinghouse Electric Corp, Buffalo, New York
MAURICE S. MOYAL — Asst. to Director and Budget Analyst, University of California, Berkeley, Calif.
J. J. ERDMAN — Mgr. Cash Control Dept., Minnesota Mining & Mfg. Co., St. Paul, Minnesota.
GENE B. GRIFFIN — Tomahawk Corn Co., Belmond, Iowa
GEORGE M. ASHE — Asst. to Budget Director, Dictaphone Corp, Stratford, Conn.
ALFRED J. FOIW — Factory Accountant, Sprague Meter Co., Bridgeport, Conn.
DONALD L. SANDERS — Acting Controller, Day-Brite Lighting Inc. of Calif., Santa Clara, Calif.
OWEN H. LEAFE — Staff Accountant, Scott Paper Co., Chester, Penna.
BERNARD MACKLE — Budget Preparation, Pacific Clay Products, Los Angeles, Calif.
HUGH K. WALKER — Budget Analyst-Long Range Forecasts, Northrop Aircraft, Inc., Hawthorne, Calif.
GEORGE F. BITTER — Asst. to Controller, The New Britain Machine Co., Manchester, Conn.
ERNEST W. EBERT, JR. — Asst. Budget Director, Evans Products Co., Plymouth, Michigan
FRANK S. NAGY — Div. Budget Director, Vickers, Inc., Sperry Rand Corp., Livonia, Michigan
ANTHONY J. PANTER — Adm. Asst. Manufacturers National Bank of Detroit, Detroit, Michigan
JAMES B. LENDRUM — Treasurer and Controller, Master Vibrator Co., Dayton, Ohio
ROBERT C. MILLECK — Accountant, The Wood Shovel & Tool Co., Piqua, Ohio
RICHARD B. ANDERSON — Asst. Budget Director, Allstate Insurance Co., Glenview, Illinois
ALDEN C. ANDREWS — Budget Accountant, Controls Co. of America, Schiller Park, Ill.
ABRAHAM BENDER — Budget Accountant, The Goss Co., Chicago, Illinois
PAUL W. BISHOP — Budget Manager, Illinois Farm Supply Co., Chicago, Illinois
WILLIAM A. JENNETT — Associate-Management Consultants, A. T. Kearney & Co., Glenview, Illinois
RAY D. KINKAID — Gen'l Supervisor of Statistics-Financial Estimates & Analyses, Illinois Bell Telephone Co., Chicago, Illinois
MARVIN M. TATE — Chief Accountant & Office Mgr., Benner Tea Co., Burlington, Iowa
HOWARD O. ULLMAN — Controller, Triangle Container Corp., Chicago, Illinois.
LEONARD WEXLER — Asst. Supervisor-Reports & Audits Section, Armour Research Foundation of Illinois Institute of Technology, Chicago, Illinois



ABOUT MEMBERS

LEO NEITZEL of the Milwaukee Chapter was a panel member at a N.A.A. discussion forum dealing with forecasting and budgeting.

A Los Angeles Chapter member, **CLAY WOODWARD** has been transferred to the Jackson Division of Aeroquip Corporation in Jackson, Michigan.

JOHN PROESCHEL has accepted a position with Aeronutronics Systems, Inc., a Ford Motor Company subsidiary, which will have its headquarters in Newport Beach, California. He will remain a member of the Los Angeles Chapter.

Congratulations to **GEORGE RAYBURN** of the St. Louis Chapter upon his appointment as Assistant Comptroller of the St. Louis-San Francisco Railroad.

ARTHUR DROST of the Milwaukee Chapter was recently promoted to Manager of Budget Control at Red Star Yeast & Products Company, and **JOHN GUIMOND** of Ray-O-Vac Company in Madison, Wisconsin was made Budget Director.

ERIC HAGBERG, has been appointed Treasurer, pro tempore, of the Detroit Chapter after **BERNARD W. KOSKI** announced his resignation due to his company's relocation in another area.

West Coast Chapter members went all-out in December to spread the name of N.S.B.B. to our brother organizations of N.A.A. and A.M.A.

Three Los Angeles chapter members appeared before different N.A.A. groups. **DICK HAWLEY** spoke before the Sacramento chapter on Reporting of Budget Performance; **BILL FEITEN**, presented a talk before the Oakland chapter covering the United Air Lines Profit Planning Program; and **BILL STRONG** participated on a panel which discussed the Forecast Side of Budgeting at the San Jose Chapter.

Participating in A.M.A. Seminars at Los Angeles were: **ROSS D. STEVENS** of our San Diego Chapter and **ALBY FOY**, **HAL COLTMAN** and **NELSON DRAKE** of our Los Angeles Chapter.

It may be of particular interest to some of our Eastern members to know that the Massachusetts Institute of Technology, School of Industrial Management, has forwarded a preliminary announcement of a Special Summer Program. It will be entitled "Controllershship-New Developments in Analysis and Control," and will be held July 7th through July 17, 1959. The various facets of Budgeting will weave an important thread in and out of the overall program. Information can be obtained by writing Professor James M. Austin; Director of the Summer Session; Massachusetts Institute of Technology; Cambridge 39, Massachusetts.

An addition to your library on Budgeting could be the reading manual used by "Professor" **JOE GRIMM** of the Milwaukee Chapter for the course in Budgeting at Marquette University. It is available at \$5.00 per copy from Dean Orville Palmer. Write to College of Business Administration, Marquette University, Milwaukee, Wisconsin and ask for "Selected Readings in Planning and Control Through Budgets."

NEW MEMBERS (Continued)

CHARLES B. GEORGE — Budget Analyst, LaSalle Steel Co., Hammond, Indiana
WINFIELD A. HOLMES — Supervisor Coat Accounting, Champion Paper & Fibre Co., Hamilton, Ohio
DONALD E. BEATTIE — Supervisor Management Services Dept., Lybrand, Ross Bros. & Montgomery, Dallas, Texas
ROBERT G. LAMBERT — Assistant Div. Controller, Stainless & Strip Div., Jones & Laughlin Steel Corp., Detroit, Michigan
HARVEY S. MILLER — Chief Accountant, General Merchandise Co., Milwaukee, Wisconsin
JOHN W. KANE, JR. — Mgr. — Financial Budget, California Texas Oil Co., Ltd., New York, N.Y.
HAROLD F. HARTEN — Budget Director, Commercial Solvents Corp., New York, N.Y.

WINSLOW MAXWELL — Budget Supervisor, General Dynamics Corp., New York, N.Y.
JOHN G. COLLINS — Budget Analyst, Allied Chemical Corp., New York, New York.
JOHN P. MALLICK — Budget Director, Twin Coach Corp.-Aircraft Div., Buffalo, New York
RICHARD BARNETT — Asst. Budget Director, Continental Air Lines, Inc., Denver, Colo.
FRANK G. COLNAR — Asst. V.P. and Budget Director, Continental Air Lines, Inc., Denver, Colo.
HARRY A. KING — Budget Supervisor, Aluminum Co. of America, Moline, Illinois
JOHN W. HOYT — Resident Partner CPA, McGladrey, Hansen, Dunn & Co., Moline, Illinois

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NOTICE

TO ALL MEMBERS

The Nominating Committee is getting ready to make its selections to present to the Membership in April.

A new President will take the helm of the Society July 1st, with a new First Vice President, a Secretary, a Treasurer, and three new Directors. Two of the Directors will be elected for three year terms, and one, who will represent the Members-at-Large for a one year term.

The retiring Directors are C. H. Eckelkamp, Past President, D. E. Bacon, Chicago and Calumet Chapters, L. C. Stetson, Dallas Chapter and L. G. Hawkins, representing the Members-at-Large.

Other Directors, who will continue to serve the Society are the retiring President, H. C. Mason, Milwaukee Chapter as Past President; A. D. Moore, San Francisco Chapter and C. O. Wessman, Cleveland Chapter until 6/30/60; C. C. Benedict, Detroit Chapter and K. R. Crawford, Indianapolis Chapter until 6/30/61.

The Nominating Committee, appointed by the Board of Directors, consists of:

Charles H. Eckelkamp, Chairman
Combustion Engineering, Inc.
200 Madison Avenue
New York 16, New York

Wm. D. McGuire
Kimberly-Clark Corporation
Lake Street
Neenah, Wisconsin

E. G. Mauck
Eli Lilly & Company
740 South Alabama Street
Indianapolis 6, Indiana

Leslie G. Hawkins
Los Alamos Scientific Laboratory
University of California
Los Alamos, New Mexico

1957-58 President, Member
of the New York Chapter.
Member of the Executive,
Planning and By-Laws Committees.

1956-57 President, Member
of the Milwaukee Chapter.
Member of the Planning
Committee.

1955-56 President, Member
of the Indianapolis
Chapter

A Director-at-Large
Representing the
Members-at-Large

This Committee will welcome proposals from the Membership for their slate. They should be sent directly to any of the Committee Members.

In addition to the Nominating Committee's selections, nominations may also be made directly by members, Article X, Section 2, Sub-section (B), of the Society By-Laws reads, "Nominations may be made in writing signed by ten members, or by the Nominating Committee appointed by the Board of Directors." Mail such nominations directly from Members to: Melvin C. Aichholz, Administrative Secretary, National Society for Business Budgeting, P. O. Box 1, Covington, Ky., no later than April 11, 1959 to be included in the official ballot mailed to the membership.